

Anticipated acquisition by Arla Foods Limited of Yeo Valley Dairies Limited, including a licence to supply certain dairy products under the Yeo Valley brand

Decision on relevant merger situation and substantial lessening of competition

ME/6737/18

The CMA's decision on reference under section 33(1) of the Enterprise Act 2002 given on 11 July 2018. Full text of the decision published on 31 July 2018.

Please note that [X] indicates figures or text which have been deleted or replaced in ranges at the request of the parties for reasons of commercial confidentiality.

SUMMARY

1. Arla Foods Limited (**Arla**) has agreed to acquire Yeo Valley Dairies Limited (**YVD**) (the **Merger**). Arla and YVD are together referred to as the **Parties**.
2. The Competition and Markets Authority (**CMA**) believes that it is or may be the case that each of Arla and YVD is an enterprise; that these enterprises will cease to be distinct as a result of the Merger; and that the share of supply test is met. Accordingly, arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.
3. The Parties overlap in the supply of organic milk in Great Britain (**GB**), in particular to major retailers with national scope (**national multiples**), and in the supply of organic butter in the UK, in particular to grocery retailers (**retailers**). The CMA has assessed the Merger in two frames of reference: (i) the supply of organic milk to national multiples in GB, and (ii) the supply of organic butter to retailers in the UK.
4. Regarding the supply of organic milk to national multiples, the CMA has found that the Parties do not compete materially for the supply of own-label organic milk. While the Parties do compete to supply branded organic milk, they are not close competitors. Moreover, alternative branded suppliers will continue to

compete with the merged entity post-Merger. Accordingly, the CMA believes that the Merger does not give rise to a realistic prospect of a substantial lessening of competition (**SLC**) as a result of horizontal unilateral effects in the supply of organic milk to national multiples in GB.

5. Regarding the supply of organic butter to retailers, the CMA has found that the Parties do not compete closely. Arla does not [X] supply branded organic butter, and the Parties do not compete to supply own-label organic butter to retailers. Moreover, alternative suppliers of both branded and own-label organic butter will continue to compete with the merged entity post-Merger. Accordingly, the CMA believes that the Merger does not give rise to a realistic prospect of an SLC as a result of horizontal unilateral effects in the supply of organic butter to retailers in the UK.
6. The Merger will therefore **not be referred** under section 33(1) of the Enterprise Act 2002 (the **Act**).

ASSESSMENT

Parties

7. Arla is the UK trading subsidiary of Arla Foods amba, an international cooperative owned by European dairy farmers headquartered in Denmark. Arla is active at various levels of the dairy supply chain, including the procurement, processing, sale and distribution, and marketing of dairy products. The 2017 turnover of Arla Foods amba was £9.0 billion. Arla's 2017 turnover was £2.2 billion, all of which was generated in the UK.
8. Yeo Valley Group Limited (**YVG**) is a UK privately-owned dairy business. It produces a range of organic and conventional dairy products. Yeo Valley Dairies Limited (**YVD**) is a subsidiary of YVG, which supplies fresh milk and butter. YVD did not trade in its last complete financial year (to 28 May 2017) because of restructuring that led to the creation of YVD in its current form. YVG anticipates YVD will generate turnover of around £[X] million in the current financial year (to 28 May 2018), of which over [X] per cent will be generated in the UK.

Transaction

9. The Merger involves Arla acquiring YVD for a consideration of £[X]. The acquisition is accompanied by several additional agreements, which provide (among other things) that Arla will obtain an exclusive and perpetual licence to use the Yeo Valley brand for the sale and distribution of milk,

butter/spreadables, and cheeses made with organic milk. The Merger does not involve the transfer of any production facilities or employees. YVG will retain control of the Yeo Valley brand, and its yoghurt, ice cream, and dessert businesses.

10. Arla's stated rationale for the Merger is to grow its sales of organic dairy products in the UK, [X]. Arla considers that the UK currently under-trades in organic dairy products compared with other European countries. It wants to use the Yeo Valley brand to stimulate and grow demand for organic dairy products.
11. YVG's stated rationale for the Merger is to allow it to focus on its core business of organic yoghurts, ice creams, and desserts.

Procedure

12. The Merger was considered at a Case Review Meeting.¹

Jurisdiction

13. The Parties submitted that Arla and YVD are two enterprises that will cease to be distinct as a result of the Merger.
14. The CMA believes that the YVD business and associated agreements together constitute an enterprise because they enable Arla to carry on YVG's business activities associated with the sale and distribution of milk and butter made with organic raw milk. Following completion of the Merger, Arla will fulfil any outstanding orders for Yeo Valley branded organic milk and butter, and will take on a large own-label agreement for organic milk and butter with a national multiple. At that point, Arla will be the only company selling Yeo Valley branded organic milk and butter in the UK. For these reasons, the CMA believes that the Merger gives rise to two enterprises ceasing to be distinct.
15. The Parties overlap in the supply of organic milk to national multiples in GB and organic butter to retailers in the UK. Their combined share for the supply of organic milk (including branded and own label) to national multiples is [50-60]% (increment of [20-30]%). Their combined share for the supply of organic butter (including branded and own label) to retailers is [80-90]% (increment of [40-50]%). The CMA therefore believes that the share of supply test in section 23 of the Act is met.

¹ See [Mergers: Guidance on the CMA's jurisdiction and procedure](#) (CMA2), January 2014, from paragraph 7.34.

16. Accordingly, the CMA believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.
17. The initial period for consideration of the Merger under section 34ZA(3) of the Act started on 17 May 2018 and the statutory 40 working day deadline for a decision is therefore 13 July 2018.

Counterfactual

18. The CMA assesses a merger's impact relative to the situation that would prevail absent the merger (ie the counterfactual). For anticipated mergers, the CMA generally adopts the prevailing conditions of competition as the counterfactual against which to assess the impact of the merger. However, the CMA will assess the merger against an alternative counterfactual where, based on the evidence available to it, it believes that, in the absence of the merger, the prospect of these conditions continuing is not realistic, or there is a realistic prospect of a counterfactual that is more competitive than these conditions.²
19. In the present case, the Parties submitted that the prevailing conditions of competition is the appropriate counterfactual against which to assess the Merger. The CMA has seen no evidence supporting a different counterfactual. Therefore, the CMA believes the prevailing conditions of competition to be the appropriate counterfactual.

Frame of reference

20. Market definition provides a framework for assessing the competitive effects of a merger. It involves an element of judgement. The boundaries of the market do not determine the outcome of the analysis of the competitive effects of the merger. There can be constraints on merging parties from outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others. The CMA will take these factors into account in its competitive assessment.³

² *Merger Assessment Guidelines* (OFT1254/CC2), September 2010, from paragraph 4.3.5. The *Merger Assessment Guidelines* have been adopted by the CMA (see *Mergers: Guidance on the CMA's jurisdiction and procedure* (CMA2), January 2014, Annex D).

³ *Merger Assessment Guidelines*, paragraph 5.2.2.

21. The Parties overlap in the supply of organic fresh⁴ milk in GB.⁵ Organic milk is produced under additional conditions to conventional milk. These conditions include limitations on the use of fertilizers and pesticides, animal welfare requirements, and access for cows to open air or grazing areas.⁶ YVD supplies only organic milk. Arla supplies both organic and conventional milk.
22. The Parties also overlap in the supply of organic butter and spreadables.⁷ Butter is made from butterfat, a by-product of milk processing. Spreadables refers to butter or buttermilk with added vegetable oil, and is sometimes referred to as spreadable butter. Previous European Commission (**EC**) cases have not distinguished between butter and spreadables.⁸ The Parties submitted that the CMA should similarly consider butter and spreadables in the same frame of reference and the CMA has seen no evidence to suggest otherwise. Therefore, in the present case, the CMA has considered butter and spreadables in the same frame of reference. References to butter in this decision should be taken to refer to both butter and spreadables.
23. YVD supplies only organic butter (both branded and own label). Arla supplies both organic (own label) and conventional (both branded and own label) butter.
24. The Parties also both procure raw organic milk. The Parties, however, do not compete materially in raw organic milk procurement because Arla sources raw organic milk mostly from its farmers, while YVD (via another subsidiary of YVG) primarily sources raw organic milk from the Organic Milk Suppliers Cooperative (OMSCO).⁹ Third parties did not raise Merger-specific concerns regarding a loss of competition in the procurement of raw organic milk. For these reasons, this activity is not discussed further in this decision.

⁴ Unless preceded by 'raw', any further references to 'milk' in this decision refer to fresh processed liquid milk.

⁵ The Parties do not materially overlap for the supply of organic milk to national multiples in Northern Ireland because in 2017, YVD supplied less than £[REDACTED] of organic milk to national multiples in Northern Ireland.

⁶ See Council Regulation 834/2007 of 28 June 2007 on organic production and labelling of organic products. Recital 1 to the Regulation explains that: 'Organic production is an overall system of farm management and food production that combines best environmental practices, a high level of biodiversity, the preservation of natural resources, the application of high animal welfare standards and a production method in line with the preference of certain consumers for products produced using natural substances and processes.'

⁷ Arla also supplies organic cheese, but it has a small share of supply of this product. The Parties said that YVD does not supply organic cheese, [REDACTED]. The CMA found that there was [REDACTED]. Given the lack of existing overlap, Arla's relatively small share, and [REDACTED], the CMA did not identify credible competition concerns in relation to the supply of organic cheese and this activity is not discussed further in this decision.

⁸ See, for example, the EC decision of 17 December 2008 on the case COMP/M.5046 – Friesland Foods/Campina ([Friesland/Campina](#)), paragraph 855.

⁹ In addition, YVG has one contract in place with an individual farm, which is specifically linked to an own-label supply contract with a national multiple.

Supply of organic milk

Product frame of reference

25. The Parties overlap in the supply of organic milk, both branded and own label. Arla's branded organic milk product, launched in 2016, is called 'Arla Organic'. YVD's branded organic milk product is called 'Yeo Valley Organic'.
26. In previous cases, the EC and UK competition authorities have consistently found that branded and own-label milk compete with one another.¹⁰ The Parties said that the CMA should consider branded and own-label milk in the same frame of reference in the present case and the CMA has seen no evidence to suggest otherwise. The CMA has therefore assessed the effects of the Merger considering own-label milk and branded milk together.
27. The CMA also considered whether the frame of reference should be widened to include conventional milk, and/or whether it should be segmented by customer type.

Organic/conventional milk

28. The Parties submitted that conventional milk is a sufficient constraint on organic milk to be included in the same product frame of reference.
29. In *Friesland/Campina*, the EC noted that there is limited substitutability between conventional and organic milk. It pointed to organic milk's higher price, consumers' specific preferences for organic milk, and differing production conditions.¹¹ In *Müller/Dairy Crest*, the CMA found that customers prefer either organic or conventional milk and would substitute organic milk for conventional milk (and *vice versa*) only if the other were not available.¹²
30. To evaluate whether organic and conventional milk should be considered in the same frame of reference, the CMA assessed demand-side substitutability based on third-party views, relative pricing, and consumer switching. The CMA

¹⁰ See, for example, [Friesland/Campina](#), paragraph 182; the OFT decision of 8 January 2007 on the completed acquisition by Dairy Crest Group plc of certain assets of Arla Foods UK plc ([Dairy Crest/Arla](#)), paragraph 17; the OFT decision of 27 October 2005 on the anticipated acquisition by Robert Wiseman Dairies plc of the fresh milk business of Scottish Milk Dairies Limited ([Robert Wiseman/Scottish Milk Dairies](#)), paragraph 17; and the CMA decision of 17 July 2015 on the anticipated acquisition by Müller UK & Ireland Group LLP of the dairies operations of Dairy Crest Group plc ([Müller/Dairy Crest](#)), paragraphs 116-119.

¹¹ [Friesland/Campina](#), paragraph 140.

¹² [Müller/Dairy Crest](#), paragraph 125. The CMA did not, however, reach a conclusion on whether the supply of organic milk and conventional milk should be considered as two separate frames of reference. Several other UK and EC investigations have also not reached a conclusion on whether organic and conventional milk should form two separate frames of reference. For example, see [Robert Wiseman/Scottish Milk Dairies](#), paragraph 17, and [Dairy Crest/Arla](#), paragraph 17.

has also considered supply-side substitutability between organic and conventional milk.

- *Third-party views*

31. The CMA investigated how national multiples would react to a small increase in the wholesale price of organic milk. Most national multiples indicated that they would accept the price increase, rather than switching to conventional milk. A large majority of national multiples also suggested that a small increase in the retail price of organic milk would have a limited impact on consumer switching from organic to conventional. Two national multiples pointed out that organic milk consumers already pay a significant premium for organic milk and a small price increase would add little to this premium.
32. Two other national multiples stated that they believed some consumers would switch to conventional milk in the event of a price rise for organic milk. They were, however, unable to estimate the extent of switching that would take place. A major competitor also said that a proportion of organic milk consumers would trade down to conventional milk should the price of organic milk reach a certain (unspecified) threshold.

- *Pricing*

33. Organic milk is typically sold at significantly higher prices than conventional milk. The CMA's comparison of the prices of various milk products across different national multiples found that the Parties' branded organic milk products (when not sold on promotion) are around double the price of conventional milk.
34. The Parties submitted that Arla Organic is, on average, closer in price to conventional milk, rather than other organic milk products. However, the CMA noted that:
 - a) Arla Organic, as a recently-launched product, has been promoted heavily with regular periods of price discounting.
 - b) Arla Organic constitutes only a small proportion of total organic milk (around [X]%)¹³ and its price is therefore not indicative of the constraint between conventional and organic milk generally.

¹³ The [X]% figure relates to Arla Organic's share of supply to national multiples. Its share of total organic milk supply might be lower since Arla Organic was mainly available in national multiples.

- c) Arla Organic's average retail price (even considering promotions) is still around [REDACTED]p per litre higher than own-label conventional milk.¹⁴

- *Consumer switching*

35. The Parties submitted that consumers regularly switch between organic and conventional milk. They provided an analysis indicating that, in the first 12 months of Arla Organic's launch, [REDACTED]% of Arla Organic's revenue was attracted from conventional milk, compared with [REDACTED]% from own-label organic milk, and [REDACTED]% from Yeo Valley Organic, with the remainder coming from other types of milk. The CMA treats this evidence with some caution given that Arla Organic was a newly-launched product sold under promotion, but the evidence is consistent with some switching between Arla Organic and conventional milk.
36. Third-party information, and one internal document, also suggest that consumers may switch between conventional and organic milk:
- a) An OMSCO report notes that 25% of households now purchase organic milk. Given that organic milk constitutes only 4.4% of the overall milk market, this would imply that a considerable proportion of households that buy organic milk also buy conventional milk. This does not, however, necessarily suggest that organic and conventional milk are demand substitutes because different members of the household may have different preferences.
 - b) A national multiple said that 18% of its customers buy organic milk, with 2% buying only organic and 16% buying both organic and conventional.
 - c) A YVG survey found that, although just [REDACTED]% of milk consumers only buy organic milk, almost [REDACTED] have bought organic and conventional milk in their lifetime. The survey, however, does not specify the timeframe over which respondents may have purchased both types of milk, or the reasons for switching between the two types.
37. Overall, this evidence suggests some limited switching between conventional and organic milk, and that conventional milk imposes some constraint on organic milk. However, the CMA believes that the evidence does not demonstrate that organic and conventional milk are sufficiently close alternatives to be in the same frame of reference, such that a hypothetical

¹⁴ This average takes into account Arla Organic's prices from its launch in 2016 until 31 December 2017.

monopolist supplier of organic milk would find it unprofitable to impose a small price increase due to consumers substituting to conventional milk.¹⁵

- *Supply-side substitutability*

38. While the boundaries of the relevant product market are generally determined by reference to demand-side substitution alone, the CMA may widen the scope of the market where there is evidence of supply-side substitution.¹⁶ The CMA would consider it appropriate to consider a frame of reference that includes both organic and conventional milk if suppliers could quickly and easily switch capacity from conventional to produce more organic milk in response to a small price increase by the Parties, and the same firms compete to supply these different products with the conditions of competition between the firms being the same for each product.
39. Competitors noted that converting land to make it suitable for organic farming took at least two years. Two competitors stated that, although new organic farmers could be recruited, the costs of conversion were considerable and farmers would be unwilling to commit unless demand could be guaranteed. Customers, in turn, may be unwilling to award large contracts to suppliers if they do not already have access to the required raw milk supply.
40. Accordingly, the CMA believes that the period required for conversion from conventional to organic appears too long, at two years or more, for organic milk to be considered in the same frame of reference as conventional milk based on supply-side substitution.¹⁷
41. For these reasons, the CMA has not included conventional and organic milk within the same product frame of reference. Nevertheless, the CMA has considered the constraint from conventional milk on organic milk in its competitive assessment.

Customer segmentation

42. The CMA may define relevant markets for separate customer groups if the effects of the merger on competition to supply a targeted group of customers differ from its effects on other groups of customers, and require a separate analysis. This may happen when, for example, suppliers can target higher

¹⁵ [Merger Assessment Guidelines](#), paragraphs 5.2.10-5.2.12.

¹⁶ [Merger Assessment Guidelines](#), paragraph 5.2.17

¹⁷ In paragraph 5.2.17, the [Merger Assessment Guidelines](#) refers to producers having the ability and incentive quickly (within a year) to shift capacity between products.

prices at customers willing to pay more, or when competition for customers differs significantly between different customer groups.¹⁸

43. The Parties submitted that product requirements and the nature of competition between suppliers vary significantly between the following different groups of customers:
- a) national multiples (ie national retailers such as Sainsbury's, Asda, Tesco, Morrison, Aldi, Lidl, Waitrose, etc);
 - b) middle ground retailers (ie other food retailers, such as petrol stations, convenience multiples, symbol groups and independent shops); and
 - c) out-of-home (OOH) customers (ie food service customers and the wholesalers who supply the food service industry).
44. In *Müller/Dairy Crest*, the CMA identified separate frames of reference for national multiples and middle ground retailers. These customers differed based on several variables, including the importance of direct-to-store delivery.¹⁹ EC decisions have also assessed the supply of milk to retail customers and non-retail customers separately, based on different requirements in terms of distribution arrangements, packaging sizes, and order volumes.²⁰
45. In the present case, the CMA's investigation found no reason to deviate from these precedents.
- a) For middle ground retailers: Third-party responses confirmed that middle ground retailers require smaller amounts of fresh milk; do not tend to have direct agreements with dairy farmers; and generally do not stock own-label organic milk. Shares of supply for branded organic milk show a significantly less concentrated market among middle ground retailers than among national multiples, with a larger number of suppliers for middle ground retailers.
 - b) For OOH customers: The CMA found that there was a broad range of customers within the segment, with some large, general foodservice wholesalers and many small wholesalers specialising in supplying small foodservice enterprises. The CMA found considerable differences in customer requirements compared with retail customers: for example,

¹⁸ [Merger Assessment Guidelines](#), paragraph 5.2.28.

¹⁹ *Müller/Dairy Crest*, paragraph 111.

²⁰ *Friesland/Campina*, paragraphs 199-206.

foodservice wholesalers require that milk is delivered in pallets, which some suppliers, [X], are not currently able to do.

46. The Parties do not compete with one another to a material extent in the supply of organic milk to either middle ground retailers or OOH customers. Third parties raised no merger-specific competition concerns regarding the supply of organic milk to these customers. For these reasons, the supply of organic milk to these customers is not discussed further in this decision.
47. Accordingly, the CMA assessed the impact of the Merger on competition in the supply of organic milk to national multiples.

Geographic frame of reference

48. In both *Arla/Express* and *Robert Wiseman/Peninsula*, the UK competition authorities adopted a GB-wide frame of reference for the supply of milk to national multiples.²¹ In *Müller/Dairy Crest*, the CMA assessed the supply of milk to national multiples at both a national and regional level. A regional assessment was appropriate as milk procurement was sometimes broken down into regional lots and the 80% catchment areas for dairies was found to be between 70km and 190km.²²
49. The Parties submitted that the geographic frame of reference for the supply of organic milk to national multiples is GB-wide. The Parties stated that they each supply organic milk to the whole of GB from one or two dairies.
50. Some suppliers of organic milk operate, or have a stronger presence, in certain regions. In the present case, however, the CMA found that it was not necessary to assess the Merger on a regional basis for national multiples because:
 - a) both YVG and Arla, as well as most of their major competitors in the supply of organic milk to national multiples, operate on a GB-wide basis and transport organic milk over long distances to do so;
 - b) through toll agreements with third-party processors, alternative suppliers can supply customers on a GB-wide basis;

²¹ See, for example, the Competition Commission decision of 15 October 2003 on the proposed merger of Arla Foods amba and Express Dairies plc (*Arla/Express*), paragraph 2.54; and the OFT decision of 23 August 2006 on the anticipated acquisition by Robert Wiseman Dairies plc of Peninsula Milk Processors Limited and Newlands Farm (Milk Link) Limited (*Robert Wiseman/Peninsula*), paragraph 19.

²² *Müller/Dairy Crest*, paragraphs 128-130.

- c) the CMA has not found any evidence to suggest that the Parties compete more closely or effectively in any particular area of GB; and
- d) third parties did not raise concerns regarding specific regions.

Conclusion on frame of reference for the supply of organic milk

51. For the reasons set out above, the CMA has assessed the impact of the Merger in the supply of organic milk to national multiples in GB.

Supply of organic butter

Product frame of reference

52. The Parties submitted that the Merger should be assessed using a frame of reference that includes margarine along with butter. The Parties, however, do not overlap in the supply of margarine products, and the CMA found that margarine products are seldom organic.²³ The CMA has therefore assessed the Merger in a frame of reference for butter (which, as discussed above, includes both butter and spreadables).²⁴
53. The Parties [X] only overlap in a combined frame of reference for the supply of both own-label and branded organic butter, since Arla does not supply branded organic butter, and the Parties do not compete to supply own-label organic butter to retailers.²⁵
54. The CMA considered whether the frame of reference for organic butter should be widened to include conventional butter, and/or whether it should be segmented by customer type.

Organic/conventional butter

55. The Parties submitted that the frame of reference should be widened to include conventional butter because:

²³ EC precedent has also defined separate product markets for butter and margarine: see EC decision of 17 December 2008 on the case COMP/M.5046 – Friesland Foods/Campina ([Friesland/Campina](#)), paragraph 855.

²⁴ Butter can come in two forms: bulk butter and packet (or block) butter. The former typically comes in portions weighing 25 kg, and is usually supplied to food manufacturers. Packet butter is much smaller and is supplied to retailers. As the Parties overlap only in the supply of packet butter, bulk butter was not considered in this investigation.

²⁵ [X].

- a) some retailers do not stock organic butter at all, indicating that they believe consumers are willing to purchase conventional products instead;
 - b) where retailers do stock both organic and conventional butter, they compete with one another for limited shelf space; and
 - c) a distinction between organic and conventional has never been made in previous decisions by the UK competition authorities or the EC.
56. Over half of the retailers who responded to the CMA's questionnaire said that they would accept a 5% wholesale price rise applied to all organic butter, with three suggesting they would alter their stocking practices. Most retailers said that, in the event of a 5% increase in the retail price of organic butter, there would be little or no consumer switching to conventional butter.
57. The Parties submitted switching evidence that appeared to show switching between organic and conventional butter.²⁶ While the data did show some switching between organic and conventional butter, it did not reveal the reasons for this switching. Consequently, the CMA could not deduce from the data the degree of switching that would result from a price increase in organic butter by a hypothetical monopolist. The CMA therefore does not place great weight on this evidence, though it acknowledges that it is consistent with conventional butter providing some constraint on organic butter.
58. The Parties also submitted price information showing that certain branded conventional butter products are priced higher than own-label organic butter. However, the CMA believes that there could be many factors driving pricing because consumers' perceptions of quality can be influenced by many factors, not just whether the butter is organic.
59. Overall, the evidence suggests that conventional butter imposes some constraint on organic butter. However, the CMA believes that the evidence does not demonstrate that organic and conventional butter are sufficiently close alternatives to be in the same frame of reference, such that a hypothetical monopolist supplier of organic butter would find it unprofitable to impose a small price increase due to consumers substituting to conventional butter.
60. Regarding supply-side substitutability, the CMA found that the same factors which apply to milk (see paragraphs 38-40) are relevant to butter. In particular, the CMA found that the time required for conversion from conventional to

²⁶ For instance, they submitted Kantar switching data indicating that, from 2017 to 2018, there was [§<].

organic is too long for organic butter to be considered in the same frame of reference as conventional butter based on supply-side substitution.

61. For these reasons, the CMA has not included conventional and organic butter within the same product frame of reference. Nevertheless, it has considered the constraint from conventional butter on organic butter in its competitive assessment.

Customer segmentation

62. The Parties submitted that the frame of reference for organic butter should be segmented by whether it is supplied to retailers (including middle ground retailers and national multiples) or OOH customers. They said that many suppliers focus on either retail or OOH customers; the brands available in each distribution channel are different; and pack sizes vary (ie 7g portions are important in the OOH channel but are not widely available in the retail channel). The Parties said that there were no significant differences in either customer requirements or the competitive conditions between middle-ground retailers and national multiples.
63. The EC has previously identified separate product markets for the supply of butter to the retail channel and the OOH channel (including in the *Arla/Milk Link* merger in the UK), due to the different customers, brands, and packet sizes involved.²⁷
64. In the present case, the CMA did not identify any evidence suggesting that the market should be segmented differently to the relevant precedents and the Parties' submission.
65. Since the Parties do not overlap in the supply of organic butter to OOH customers, the CMA has only considered the supply of organic butter to retailers.

Geographic scope

66. The Parties submitted that the geographic frame of reference for the supply of organic butter should be EEA-wide because a significant proportion of butter sold in the UK is imported.
67. However, the CMA received evidence from many retailers (both national multiples and middle ground retailers) that all the *organic* butter stocked by

²⁷ See, for example, [Friesland Foods/Campina](#), paragraph 870; and the EC decision of 27 September 2012 on the case COMP/M.6611 – *Arla Foods/Milk Link* ([Arla/Milk Link](#)), paragraph 33.

each of these customers originated from within the UK. Accordingly, the CMA did not consider it appropriate to use a wider frame of reference than the UK. The CMA did identify several examples of retailers stocking *conventional* butter that originated from elsewhere in Europe. Therefore, to the extent that organic butter is constrained by conventional butter, the CMA acknowledges that the constraint may extend to imports.

Conclusion on frame of reference for the supply of organic butter

68. For the reasons set out above, the CMA has assessed the impact of the Merger in the supply of organic butter to retailers in the UK.

Competitive assessment – horizontal unilateral effects

69. Horizontal unilateral effects may arise when one firm merges with a competitor that previously provided a competitive constraint, allowing the merged firm profitably to raise prices or to degrade quality on its own and without needing to coordinate with its rivals.²⁸ Horizontal unilateral effects are more likely when the merging parties are close competitors.
70. The CMA assessed whether it is or may be the case that the Merger has resulted, or may be expected to result, in an SLC in relation to horizontal unilateral effects in the supply of (i) organic milk to national multiples in GB; and/or (ii) organic butter to retailers in the UK.

Supply of organic milk to national multiples in GB

71. To assess the likelihood of the Merger giving rise to a realistic prospect of an SLC as a result of horizontal unilateral effects in the supply of organic milk to national multiples in GB, the CMA has considered the Parties' shares of supply, the closeness of competition between the Parties, and the remaining competitive constraints.

Shares of supply

72. The Parties supply [X] of the 10 national multiples with organic milk. In terms of branded organic milk, which accounts for approximately 20% of all organic milk sold to national multiples, YVD supplies [X] national multiples and Arla

²⁸ [Merger Assessment Guidelines](#), paragraphs 5.4.1-5.5.19.

supplies [X] national multiples. Regarding own-label organic milk, Arla supplies [X] national multiples and YVD supplies only [X].

73. The Parties' combined share of supply of organic milk (including both branded and own label) is [50-60]% (with an increment of [20-30]%). The main competitor is Müller, which has an estimated share of supply of 30%. The remaining competitors include Rachel's and Graham's.

Closeness of competition

74. As explained above, Arla supplies both branded organic milk (Arla Organic, launched in 2016), and own-label organic milk to national multiples. Arla Organic has been promoted heavily, but has a very small share of the total supply of organic milk (around [0-5]%). Most of Arla's organic milk sales derive from own-label organic milk (representing around [20-30]% of the total supply of organic milk).
75. By contrast, YVD has a strong branded milk product (Yeo Valley Organic), which accounts for around [10-20]% of the total supply of organic milk. YVD has a limited presence in own-label organic milk, supplying just [X].
76. Given this different focus for the Parties' businesses, the CMA assessed the closeness of competition first between Arla's and YVD's branded organic milk products; and, second, between Arla's and YVD's own-label organic milk.

Closeness between Arla Organic and Yeo Valley Organic

77. In assessing the closeness of competition between the Parties, the CMA considered: (i) the impact of Arla Organic's 2016 entry on Yeo Valley Organic's sales; (ii) customer views on substitutability between Arla Organic and Yeo Valley Organic and the loss of competition resulting from the Merger; and (iii) internal documents relating to competition between the Parties.

- *Impact of Arla Organic's entry*

78. Arla Organic was launched in 2016 and is now sold in [X] national multiples.²⁹
79. The Parties submitted an analysis comparing consumer spending on milk products in the 12-months preceding the launch of Arla Organic with the 12-months following the launch of Arla Organic. The information was gathered by tracking the spending habits of 30,000 UK consumers. According to the

²⁹ An additional national multiple [X].

Parties' analysis, Yeo Valley Organic lost [X] litres to Arla Organic, which represents just [X]% of all Yeo Valley Organic's 2017 sales (measured in litres).

80. The CMA has some reservations about the methodology used to estimate switching between the Parties' organic milk products, in particular because it does not control for any changes in consumer behaviour that would have occurred absent the launch of Arla Organic.³⁰ The CMA nonetheless believes that the analysis is consistent with a low degree of switching (albeit potentially slightly higher than suggested by the Parties), and indicates that the impact of Arla Organic's entry has been relatively limited.
81. Evidence from national multiples that have stocked Arla Organic also supports this view. A national multiple estimated that Arla Organic took less than 5% of Yeo Valley Organic's sales during a short-term promotion in which Arla Organic was heavily discounted. The national multiple stated that the low level of switching was because Yeo Valley Organic is an established brand for which consumers are willing to pay a premium.
82. Similarly, the Parties' internal documents note that, [X], the impact of Arla Organic's entry had generally been very limited.
83. Overall, the evidence from the switching analysis, from national multiples, and from the Parties' internal documents suggests that Arla Organic's entry has not materially affected Yeo Valley Organic and that the Parties do not compete closely in the supply of organic milk to national multiples.

- *Customer views*

84. Most national multiples had no concerns regarding the Merger. Four of six national multiples said they would respond to an attempted post-Merger price rise by switching volumes to rival suppliers or by simply delisting the products.
85. The national multiples indicated that, while the Parties' branded organic products are alternatives, they are not close alternatives, primarily due to the weakness of Arla's brand compared with the Yeo Valley brand.

³⁰ The analysis compares one 12-month period with another, but does not allow for any changes in behaviour that would have occurred in the absence of the launch of Arla Organic. More specifically:

- (i) Switching between products is inferred and sensitive to the assumptions used. For example, the Parties submitted two different Kantar calculations estimating switching volumes from Yeo Valley Organic to Arla Organic. The change in methodology resulted in the estimate of the volume lost to Arla Organic falling from [X] to [X] litres.
- (ii) The analysis may not identify when consumers switch a proportion of spend between Yeo Valley Organic and Arla Organic if their total spending on organic milk increased over the period in question.

86. One national multiple told the CMA that it had decided to delist Yeo Valley Organic from several of its stores in favour of Arla Organic. It considered that the products were like-for-like substitutes and that Yeo Valley Organic customers would switch to Arla Organic. However, this national multiple was also not concerned by the possibility of a loss of competition arising from the Merger, instead citing potential benefits in the form of lower production costs.
87. One national multiple did raise concerns that the Merger would result in the loss of its ability to negotiate better deals from the two biggest suppliers of branded organic milk. As discussed in paragraphs 98-112 below, however, the CMA found that there are several alternative suppliers of branded organic milk. In addition, one national multiple corroborated the Parties' submission that a national multiple could sponsor the entry or expansion of a branded organic milk product.

- *Internal documents*

88. YVG's and Arla's internal documents indicate that conventional milk, own-label organic milk, and other branded organic milk products all exert a more significant constraint on the Parties in their supply of branded organic milk than their branded products exert on each other.
89. In several presentations to national multiples, Arla stated that [REDACTED].
90. In some of YVG's documents, [REDACTED].³¹ Some YVG board presentations also support the view that [REDACTED].

- *Conclusion on closeness between Arla Organic and Yeo Valley Organic*

91. The introduction of Arla Organic has had only a small impact on sales of Yeo Valley Organic. Most of Arla Organic's customers have come from either own-label organic or conventional milk, rather than from Yeo Valley Organic. There is a significant price differential between Arla Organic and Yeo Valley Organic. Third parties have supported the view that Arla Organic and Yeo Valley Organic are targeting largely different end-customers.
92. Overall, the CMA believes that this evidence indicates that Arla Organic and Yeo Valley Organic are not close competitors for the supply of branded organic milk to national multiples.

³¹ [REDACTED].

Closeness between Arla and YVG own-label organic milk

93. YVG only supplies [REDACTED] with own-label organic milk, through a long-term processing agreement, and it [REDACTED]. The Parties submitted that they have [REDACTED] bid against one another for an own-label organic milk contract, for the following reasons:
- a) [REDACTED].
 - b) [REDACTED].
 - c) [REDACTED].
94. Only one customer indicated that it considered the Parties to be close alternatives for own-label organic milk. This customer had approached YVG about becoming its supplier of own-label organic milk, but [REDACTED]. Other national multiples confirmed that YVG is unlikely to have the processing capacity to be able to supply them with own-label organic milk.
95. Overall, the CMA believes that this evidence indicates that the Parties are not close competitors for the supply of own-label organic milk to national multiples.
96. The CMA notes that own-label organic milk may be a constraint on branded organic milk, in particular as Arla is the largest supplier of own-label organic milk and YVD is the largest supplier of branded organic milk. The CMA therefore considered the interaction between Arla's position in own-label and YVD's position in branded organic milk. However, as set out below, the CMA found that there were sufficient remaining constraints from other suppliers for both types of supply.

Competitive constraints

97. The Parties submitted that sufficient alternative suppliers of organic milk to national multiples will remain post-Merger to constrain the Parties. Moreover, there would be some additional constraint from conventional milk (eg as discussed above at paragraphs 89-90, Arla's documents indicate that it priced organic milk by considering the price of conventional milk).
98. The CMA found that, in YVG's business plans and monthly reviews, it discusses [REDACTED] as alternative suppliers of branded organic milk with which it competes. In one of these documents, [REDACTED] is noted as increasingly diversifying into top-tier premium organic milk products, suggesting that it is becoming a closer competitor to YVG. Arla's documents most frequently discuss [REDACTED] as competitors in own-label and branded organic milk.

99. While most national multiples considered the Parties to be among their principal suppliers of organic milk, they were all able to name at least one credible alternative to the Parties, with Müller, Graham's, Rachel's, and Medina named most frequently.
100. The CMA has assessed the competitive constraint that each of these four suppliers would exert on the Parties post-Merger. The CMA notes that the national multiple that raised concerns regarding the loss of competition resulting from the Merger questioned the extent to which suppliers other than the Parties could meet their requirements, both in terms of volumes and geographical reach. Therefore, for each of these alternative suppliers, the CMA has considered specifically these factors.

Müller

101. The Parties estimated that Müller currently accounts for [X] of the organic milk supplied to national multiples in GB, the vast majority of which is own label. Müller currently supplies most national multiples with own-label organic milk on a GB-wide basis, including [X]. The Parties submitted that Müller has the processing facilities, spare capacity, logistics, financial resources and customer relationships to remain a strong competitor post-Merger.
102. Müller confirmed to the CMA that [X].
103. Every one of the 10 national multiples named Müller as an alternative supplier to the Parties, and bidding data supplied by the Parties indicated that it competes very closely with Arla for own-label organic milk contracts with national multiples.

Graham's

104. Graham's supplies branded organic milk to various national multiples, including Sainsbury's, Waitrose and Lidl, and [X].
105. Although Graham's total share of supply of organic milk to national multiples is estimated to have been [X] in 2017, [X].
106. Graham's confirmed [X].

Rachel's

107. Rachel's is an organic milk brand, which was bought by Lactalis in 2010. [X].

108. Only three national multiples mentioned Rachel's as a viable alternative to the Parties, in each case for branded supply. However, [REDACTED].

Medina

109. Medina, [REDACTED]. The Parties said that Medina has sufficient processing capacity to remain a viable alternative, though the CMA was unable to verify this information.

Sourcing raw organic milk

110. Müller and Graham's both confirmed that they compete with the Parties and [REDACTED]. However, both stated that their ability to compete with the Parties could be affected by access to raw organic milk. [REDACTED] and two smaller competitors raised similar concerns.
111. However, unlike these competitors and YVG, the CMA found that Arla procures most of its raw organic milk directly from its farmer members. Arla's ambition is to increase demand for organic milk to enable its farmers to convert from conventional to organic. By contrast, YVG and the competitors source organic milk from farms or farm collectives, such as OMSCO. For this reason, the Merger has little effect. If anything, the merged entity could be [REDACTED], increasing the available supplies through OMSCO to competitors. The merged entity's ability to procure raw organic milk will not be significantly enhanced by the Merger. For this reason, the CMA does not believe that the Merger will make it more difficult for alternative suppliers to source raw organic milk.
112. The Parties also submitted that there is currently an excess of organic milk available, with Arla discounting on average over [REDACTED] litres of organic milk each year between 2015 and 2017 (ie selling organic milk as conventional milk). OMSCO, the largest organic milk farmers' cooperative in the UK, confirmed that [REDACTED]. The evidence accordingly suggests that access to raw organic milk is not currently a significant barrier to expansion for competitors to the Parties.

Conclusion on horizontal unilateral effects in the supply of organic milk to national multiples in GB

113. For the reasons set out above, the CMA believes that although the Parties have a high combined share of supply, they are not close competitors in the supply of organic milk and sufficient competitive constraints will remain post-Merger. Accordingly, the CMA believes that the Merger does not give rise to a

realistic prospect of an SLC as a result of horizontal unilateral effects in the supply of organic milk to national multiples in GB.

Supply of organic butter to retailers in the UK

114. To assess the likelihood of the Merger giving rise to a realistic prospect of an SLC as a result of horizontal unilateral effects in the supply of organic butter to retailers in GB, the CMA has considered the Parties' shares of supply, the closeness of competition between the Parties, and the remaining competitive constraints.

Shares of supply

115. The Parties initially submitted that their combined share of supply of organic butter to retailers in the UK is [80-90]% (with an increment of [40-50]%). However, later in the CMA's investigation, the Parties said that, since their initial submission, Arla had [X] so their combined share was now around [60-70]%.

Closeness of competition

116. Arla does not currently sell branded organic butter to retailers. Arla submitted that [X].
117. Regarding own-label organic butter, the Parties submitted:
- a) YVD [X] tenders to supply own-label organic butter to national multiples in the last five years. It supplies just [X] national multiple with own-label organic butter, with whom it has a long-term, established relationship.
 - b) Arla [X] the national multiple supplied by YVD in the past five years. As with organic milk, Arla said that it is [X].
118. The CMA did not identify any information in the Parties' internal documents that contradicted these submissions.
119. Third parties confirmed that Arla is a supplier of own-label organic butter and YVG is a supplier of branded organic butter. One major retailer questioned whether YVG would have the capacity to supply it with own-label organic butter. Third parties did not generally consider the Parties to be close alternatives for the supply of organic butter.

Competitive constraints

120. The Parties submitted that several alternatives are available to customers for both branded and own-label organic butter, including Wyke Farm, Calon Wen, Graham's, and Dairy Crest. In particular, the Parties emphasised that Müller will continue to exert intense competition on the Parties post-Merger for own-label contracts.
121. Most customers did not raise concerns about the Merger. Overall, customers named nine alternatives to the Parties for both own-label and branded organic butter, with Müller, Graham's, Castle Dairies, Wyke Farms, and Rachel's being the most commonly mentioned. Three large retailers confirmed that Müller had bid against Arla to supply them with own-label organic butter in 2018.
122. Only one retailer raised a concern relating to a perceived loss of bargaining power when negotiating prices with Arla for the supply of own-label organic butter. It said that YVD (although uncompetitive relative to Arla) was nevertheless a more credible alternative than other potential suppliers. However, the third party also said that Müller, Kerry, Wyke Farm, Graham's, and Rachel's were all credible alternatives and, given YVD [X], the CMA does not believe YVD would be a more credible alternative than these other suppliers.
123. Several YVG internal documents also discuss the constraint on organic butter from conventional butter. This is in the context of the [X], but indicates that there is some additional constraint on the supply of organic butter from conventional butter.

Conclusion on horizontal unilateral effects in the supply of butter to retailers

124. For the reasons set out above, the CMA believes that although the Parties have a high combined share of supply, they are not close competitors in the supply of organic butter and sufficient competitive constraints will remain post-Merger. Accordingly, the CMA believes that the Merger does not give rise to a realistic prospect of an SLC as a result of horizontal unilateral effects in the supply of organic butter to retailers in the UK.

Barriers to entry and expansion

125. Entry, or the expansion of existing firms, can mitigate the initial effect of a merger on competition, and in some cases may mean that there is no SLC.

126. In the present case, the CMA has not had to conclude on barriers to entry or expansion as the Merger does not give rise to competition concerns on any basis.

Third party views

127. The CMA has taken into account third-party comments where appropriate in its competitive assessment above.

Decision

128. Consequently, the CMA does not believe that it is or may be the case that the Merger may be expected to result in an SLC within a market or markets in the UK.

129. The Merger will therefore **not be referred** under section 33(1) of the Act.

Mike Walker
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Competition and Markets Authority
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